



**TO** | Signature Clients  
**FROM** | Signature Investment Committee  
**DATE** | January 24, 2017  
**RE** | Fourth Quarter 2016

## **Commentary**

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“It is astonishing that so little knowledge can give us so much power.”

Bertrand Russell (1872-1970)

The amount of ink spilt on the upcoming policies of the Trump administration is truly astonishing given how little the media understands regarding their intent, construction or potential implementation and execution. In this letter, I would like to set aside media conjecture and focus instead on a single potential policy prescription, while attempting to explain its political and economic underpinnings. I do not wish to judge whether this particular policy approach will work or whether it is wise. Rather, I simply wish to show the underlying structure of the Trump administration’s approach towards trade policy. You may not agree with the principals of this approach towards trade but hopefully you will see it does have an intellectual basis and not simply an emotional one.

The Trump administration has made it clear that they intend to take a new approach towards trade policy including “rewriting” existing bilateral and multilateral trade agreements. Many in the media and “free traders” are dismayed at this prospect as there is both a superficial belief that this is “not the American approach” toward trade and an ingrained belief that trade - while harmful to many individuals - is greatly beneficial to the broad swath of society. In an open and free trade environment, resources flow to where they are best utilized and everyone benefits since organizations “play to their strengths” rather than each participant having to create for himself everything he wishes to consume. Free trade tends to lead to lower unemployment, higher wages, lower inflation and less poverty for the world. No one would deny that capitalism and free trade have lifted billions of people out of poverty since World War II.

Free trade did not just happen – it had a political reason for being born.

It has also led to the United States running a trade deficit of \$600 billion in 2016 alone. This trade deficit is an enormous drag on U.S. growth as imports subtract from our country’s calculation of its GDP. Therefore, it is worth looking at how free trade came to be the norm since the end of the 1940’s, why it is being questioned today, and why some believe it is time for a new approach.

In 1944, the U.S held a meeting for 44 participants in a New Hampshire town named Bretton Woods. Most recall the meeting was born out of the determination of U.S. President Franklin

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D. Roosevelt and U.K. Prime Minister Winston Churchill to ensure post-war prosperity through economic cooperation, thereby avoiding the economic conflicts between countries in the 1930's, which they believed contributed to the march toward war. Out of these meetings the United Nations, the International Monetary Fund and the World Bank were ultimately created. These organizations laid the groundwork for the Marshall Plan, encouraged free trade and led to strong economic growth for the United States as well as the other participants. Most importantly, the U.S. dollar was designated to hold the supreme position in the world economy thereby allowing the United States to run consistent trade deficits without having to devalue against gold – to which it was linked at the time. Finally, the United States promised to guarantee this approach to economic integration by policing all shipping lanes on the oceans, whether trade involved the U.S. or not.

So let's review – World War II is close to an end and all the Allies and most Axis powers agree to lay down arms and stand down their naval fleets in exchange for the United States ensuring the safety of all while encouraging free trade as widely as possible across the globe. Hence, the resources many went to war to procure, such as food or energy, would now be available for them to purchase or acquire by trade. The United States agreed to open its domestic market to the world following the war, without asking for reciprocity from others. The U.S. understood other countries' need to export their way to health following the devastation of the war.

In essence, the United States agreed to run persistent trade deficits to allow other countries to grow and emerge from the devastation of World War II. What did the United States get in exchange for this generosity? We created an alliance that promised to fight with us against a potential new enemy – the Soviet Union. The logic, while politically driven, was sound and the economic burden on the United States was considered fair given the threat the U.S. perceived to exist on the other side of the Iron Curtain.

Today, many think the bargain looks less sound and less fair. The Soviet Union fell apart 25 years ago and although Russia today is viewed as an irritant, it is a country that is growing old, sick and beginning to shrink demographically. Although the country still needs to be watched, it is clearly not the existential threat that the old Soviet Union was. So the question has become, What does the United States gain by continuing to run massive trade deficits? Some conclude the answer is “nothing”. Hence, the Trump administration is having discussions regarding renegotiating trade agreements and adjusting agreements toward trade that might be viewed as “fair” from the United States' point of view. As a country we simply may not be able to afford to police the world, accept all imports while allowing restrictions to be imposed on U.S. exports, and expect to be able to pay our internal unfunded liabilities (Social Security, Medicare, etc.) which today total over \$105 trillion.

The knee jerk assumption is that China will rise to replace the U.S. as the bastion of free trade. Listen closely...there is not a chance of that happening. China has risen utilizing a purely mercantilist approach to increase the nation's wealth and employ as many people as possible. The nation's economy is predicated on exports, restricting imports and maintaining a trade surplus.

If the U.S. moves in the direction of ensuring a fairer trade environment for us, will there be winners and losers? Indeed, there will be an economic reordering and countries that are wholly dependent on trade will suffer the most. Will we all lose? That is possible, but given that

exports account for less than 15% of U.S. GDP and new technologies could allow us to become truly energy independent – the United States would far and away be the least harmed in an era of potential new trade rules.

It will be interesting to watch how this all unfolds; but remember, there is a logic to rethinking our current approach to trade. Bretton Woods was an “America First” moment as we required help in standing up to the Soviet Union and communism. Today is another potential “America First” moment. Simply because it is an unfamiliar construct, does not mean it is wrongheaded or simpleminded. There was a logic for the current trade structure just as there is for a potential future trade structure.